

## IRS Oversight Board

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**WRITTEN TESTIMONY FOR  
IRS OVERSIGHT BOARD CHAIRMAN  
RAYMOND T. WAGNER, JR.  
HOUSE WAYS AND MEANS  
SUBCOMMITTEE ON OVERSIGHT  
HEARING ON  
2005 TAX RETURN FILING SEASON AND THE IRS BUDGET FOR FISCAL YEAR 2006  
APRIL 14, 2005**

Thank you, Mr. Chairman for this opportunity to testify before the subcommittee and to present the IRS Oversight Board's views on the President's proposed FY2006 budget for the Internal Revenue Service.

I also want to thank and commend you and the members of the subcommittee for your continued oversight of tax administration issues. It is greatly appreciated. And I believe that I speak not only for the Board, but the entire tax administration community when I say how much we will miss Representative Portman. He has been an outstanding advocate for America's taxpayers.

Mr. Chairman, the IRS Oversight Board recently released its FY2006 IRS Budget Report. I would like to ask that this report be entered into the record.

### **Three Influencing Factors**

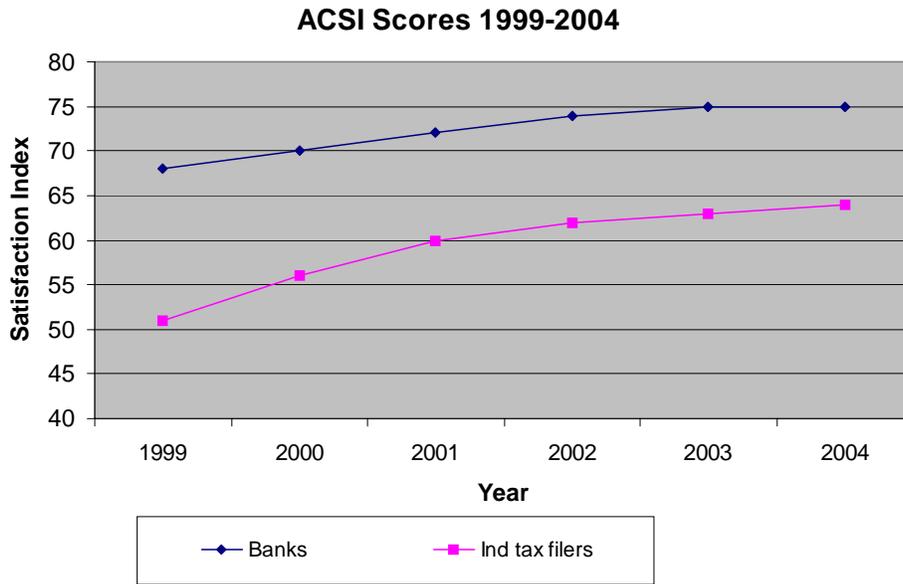
Before describing the Board's budget recommendations for the FY2006 IRS budget, I want to present three factors that influenced the Board's recommendations

First, the Oversight Board must weigh competing factors when considering the budget it recommends. The Board is cognizant that the world situation and projected deficits for the next several years increase the need to ensure that all federal spending be thoroughly justified, deliver value to the taxpayers, and meet priority needs. However, in our roles as members of the Oversight Board, we must always be mindful of how well the tax administration system is serving taxpayers.

Second, the Board believes that with an effective tax administration system, taxpayers would find compliance easy to achieve and difficult to avoid. This simple paradigm illustrates the balance between service and enforcement that must be achieved. Those who need service to be compliant should receive it; those who flout the law should be identified and pursued.

Third, taxpayers should feel that the service they receive is valuable to them and to society. While the tax collector will never win a popularity contest, the Oversight Board's most recent taxpayer attitude survey found wide support for additional funding for the IRS – 62 percent of respondents favor more funding for enforcement and 64 percent favor more taxpayer assistance. The Board believes that this finding underscores a fundamental belief that our tax administration should operate in a way that is balanced between *both* service and enforcement.

In fact, the willingness of a majority of taxpayers to support additional funding for the IRS reflects the increasing levels of satisfaction that taxpayers show in the IRS. Taxpayer satisfaction surveys such as the American Customer Satisfaction Index (ASCI) have shown a steady increase since 1999, as shown in the figure below.



**FY2004: Across-the-Board Progress**

The Oversight Board has advocated balance since its inception and it applauds the IRS for staying focused and raising both service and enforcement performance levels in FY2004 while also seeking greater efficiencies through its modernization program. The Board's recent budget report describes improved performance the IRS has achieved in FY2004 in three important areas: (1) customer service, (2) business systems modernization and (3) enforcement.

Telephone service has greatly improved, helping taxpayers navigate an extremely complex tax code. In 2005, the IRS estimates that more than half of individual taxpayers will file their returns electronically and millions are using the IRS web site to download forms, get information on their tax law questions and track the status of their refunds. The IRS' computer modernization program met its cost and schedule milestones in 2004 and the first taxpayers have been moved off the old tape-based system to a modern reliable database. And although the agency's enforcement effort has been suffering from a declining resource base, in FY2004 the IRS was able to increase its enforcement resources and showed an impressive gain in enforcement revenue.

While progress has been made, we still face an enormous challenge: our nation's tax gap – the amount of known taxes that are not paid. We all heard last week that as of 2001, the gap stood at between \$312 and \$353 billion; a slight increase from 1988, which was the last time the IRS measured the amount of known unpaid taxes.

To put this into perspective, if all taxpayers paid what they owe each year, our government would have enough money to cover more than 85 percent of the cost of operating<sup>1</sup> all non-defense and non-homeland security agencies.

<sup>1</sup> According the Office of Management and Budget, in FY2004, discretionary budget authority for non-defense and non-homeland security totaled \$386 billion. The mid-point of the tax gap range, \$333 billion, is 86 percent of this amount.

With that in mind, I think we can all agree that the job is far from done. A lot more hard work is still required if the IRS is to become the tax administration agency envisioned by the authors of the IRS Restructuring and Reform Act of 1998.

**FY2006 Budget Recommendation**

Mr. Chairman, let me now turn to President Bush's FY2006 budget request for the IRS. There is much to like in this request. First, the Oversight Board recognizes and appreciates that at a time when most budgets are being tightened, the President is asking for a greater budget increase for the IRS than other non-defense and non-homeland security agencies.

The Board is heartened by the request for additional enforcement funding and is pleased that the Administration acknowledges that investments in IRS enforcement result in increased tax revenue.

In addition, the President's focus on tax reform is most welcome by not only the Board, but all honest taxpayers. In the long term, simplification of the code will reduce the burden on America's taxpayers and in turn, on IRS customer service and even enforcement. In the short term, however, changes to the tax code will almost certainly increase the demand for IRS customer service.

With that in mind, the Board's recommendation builds on the President's budget request. It proposes a budget that it believes will allow the IRS to fully achieve its strategic goals and objectives. It calls for \$11.6 billion in funding for FY2006, a nine percent increase over the Administration's recommendation.

<b>Comparison of Administration's Request, IRS Oversight Board's Recommendation, and Enacted Appropriations (in \$ millions)</b>				
<b>FY2005</b>			<b>FY2006</b>	
<b>Admin.</b>	<b>Oversight Board</b>	<b>Enacted</b>	<b>Admin.</b>	<b>Oversight Board</b>
10,674	11,206	10,233	10,679	11,629

The Board believes that the IRS must begin to close the tax gap through greater enforcement. For that reason, we recommend an additional \$435 million for IRS enforcement efforts that could easily generate more than a billion and a half dollars in additional tax revenue using the Administrations return on investment of four-to-one. From its private sector perspective, the Board believes it makes perfect sense to make the additional investments in enforcement that will pay for themselves many times over.

The Board also recommends additional funding towards maintaining and improving customer service and supporting the BSM program. We are concerned that proposed reductions in customer service and modernization resources in the proposed FY2006 budget will have a negative impact on the IRS' ability to delivery quality service to taxpayers, which ultimately will also have a negative effect on taxpayer compliance.

The IRS has already announced that it will end its TeleFile service, used by almost four million taxpayers. Another example of reduction in service is the requirement that tax return and tax account transcripts provided by Taxpayer Assistance Centers (TACs) must now be requested by phone or mail, which requires a two-week waiting period. These transcripts are often needed urgently by those applying for mortgages or other loans. This change in procedure burdens taxpayers and is counter to the IRS commitment to provide excellent customer service.

Other possible customer service cuts may include:

- Closing some Taxpayer Assistance Centers, which in total serve 7.5 million taxpayers each year, many of them elderly and lower-income taxpayers and those with limited or no English proficiency;
- Reducing hours on the IRS' toll-free lines; and
- Providing fewer paper versions of forms and publications, further burdening lower-income taxpayers who do not have ready access to the Internet.

Business systems modernization is also key to improving customer service and enforcement. The program should be accelerated, not only to reduce costs and speed up delivery time, but to avoid a catastrophic collapse of the IRS' archaic legacy computer systems.

However, for the past few years, the IRS has slowed down modernization even though it has demonstrated that past problems can be overcome and tangible benefits can be delivered to taxpayers.

Mr. Chairman, the IRS needs a realistic budget that recognizes and provides for the anticipated expenses it will likely incur, such as congressionally-mandated pay raises, inflation and rent increases. By not fully funding these costs – as has been the case in the past – the IRS may yet again be forced to make program cuts to pay for them.

Unfortunately, while we may completely agree that the Board's budget recommendations deliver value to taxpayers, the existing budget evaluation methodology makes it difficult to act on these recommendations because it considers enforcement initiatives simply as an expense, and does not recognize the amount of revenue that will be raised.

### **Changing the Way Congress Assesses the IRS Budget**

For that reason, the Board is pleased to see the Administration's recommendation to adjust 302(a) allocations to increase enforcement funding for the IRS.

However, it is unclear how this recommendation could play out should Congress accept it. The Board is concerned that there could be unintended consequences. The recommendation could result in additional reductions in taxpayer services or modernization should budgets be cut or unanticipated costs arise.

To deal with these potential problems, the Board recommends that Congress reviews a full range of alternatives that recognize the value of investing in IRS enforcement. These options could include revisiting the Office of Management and Budget's own budget methodology regarding enforcement revenue, authorizing enforcement increases under non-discretionary funding, or allowing the IRS to retain a small percentage of enforcement revenue. The Board recognizes that several of these options fall under the jurisdiction of this Committee, and the Board urges the Committee to give this recommendation active consideration.

### **Conclusion**

Mr. Chairman, in conclusion, the Board strongly believes that our nation can ill afford to return to the days when the IRS fluctuated between customer service and enforcement. We cannot shift resources to pursue those who knowingly avoid taxes while neglecting the needs of honest taxpayers attempting to comply with a complex tax code. As I mentioned in the beginning of my testimony, in an effective tax administration system taxpayers would find compliance easy to achieve, but difficult to avoid.

The IRS is now solidly on the right track and is making progress toward that goal but we must give it the resources to do its job. Thank you and I would be happy to answer your questions.